



COUNTY OF LOS ANGELES
TREASURER AND TAX COLLECTOR



MARK J. SALADINO
TREASURER AND TAX COLLECTOR

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June 15, 2004

TO: Supervisor Don Knabe, Chairman
Supervisor Gloria Molina
Supervisor Yvonne B. Burke
Supervisor Zev Yaroslavsky
Supervisor Michael D. Antonovich
Harmonich (for)
FROM: Mark J. Saladino
Treasurer and Tax Collector

SUBJECT: **2004-05 TAX AND REVENUE ANTICIPATION NOTES**

My office sold \$600,000,000 in Tax and Revenue Anticipation Notes (TRANs) priced today at a 3.00% coupon with a reoffering yield of 1.60%. The lead banker, Lehman Brothers, was successful in selling the County's TRANs in a negotiated transaction at an aggressive price. This is the second lowest yield we have achieved since the inception of this program in 1977.

The pricing of the Notes benefited from favorable market technicals in comparison to the prior week. The "core" Consumer Price Index (CPI) rate released today was 0.2%, which was below consensus estimates of 0.3%, and eased concerns that the Federal Reserve would pursue more rapid and higher increases in the federal funds rate. As a result, Treasury prices rallied with a corresponding decline in taxable yields that also extended into the tax-exempt market. Our pricing today also benefited from a significant amount of tax-exempt short-term securities that are maturing next week. Thus, our County's TRANs provided an attractive alternative to investors looking to reinvest in comparable short-term securities.

I have attached copies of the rating reports from Standard & Poor's, Moody's and Fitch, which all reflect their highest short-term ratings for the County. I have also attached a copy of the Preliminary Official Statement for this transaction, and will forward the final Official Statement as soon as it becomes available. If you have any questions regarding this transaction, please contact me or your staff may contact Glenn Byers of my office at 974-7175.

MJS:GB:BLC
Z:Board:2004-05 TRANs pricing memo to bos

Attachments

c: Executive Officer, Board of Supervisors
Chief Administrative Officer
Auditor-Controller
County Counsel

STANDARD &POOR'S	RATINGS DIRECT
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Research:

Return to Regular Format

Summary: Los Angeles Cnty, CA; Tax Secured, Note

Publication date: 10-Jun-2004

Credit Analyst: David G Hitchcock, New York (1) 212-438-2022; Gabriel Petek, San Francisco (1) 415-371-5042

Credit Profile

US\$600. mil 2004-05 TRANs ser A dtd 07/01/2004 due
06/30/2005

SP-1+

Sale date: 15-JUN-2004

■ Rationale

Standard & Poor's Ratings Services assigned its 'SP-1+' short-term rating to Los Angeles County, Calif.'s \$600 million 2004-2005 TRANs series A, reflecting:

- The county's diverse economy, with a population of 10.1 million, and good general creditworthiness ('A+' long-term GO rating);
- A note structure that includes early set-asides of TRAN repayment amounts; and
- Strong overall debt service coverage by net general fund cash balances and other cash resources, as well as historically conservative county cash flow projections.

The TRANs are secured by a first lien on lawfully available taxes, income, revenues, and other unrestricted money received by the county and attributable to fiscal 2005. The county is not authorized to levy a tax for the repayment of the notes. The county must set aside \$209 million for note repayment from its first unrestricted money after Dec. 20, 2004; \$109 million after Jan. 1, 2005; \$68 million after Feb. 1, 2005; \$73 million after March 1, 2005; and \$141 million, plus accrued interest, after April 20, 2005.

Coverage by net general fund cash balances alone at fiscal year-end June 30, 2005, is projected to be strong at 1.60x, consistent with the very high cash coverage of recent years. The county's cash flow projections over the past few years have, in fact, proven conservative. The county's actual cash coverages of previous TRANs issues sold in fiscals 2002, 2003, and 2004 were 1.88x, 1.80x, and 2.06x, respectively--higher than projected cash coverages of 1.75x, 1.29x, and 1.64x at the time each of the original TRANs were sold. In addition to \$371.4 million of projected general fund cash at fiscal year-end 2005, the county has access to other significant internal cash sources if general fund revenues do not meet projections. These additional sources include a variety of other funds of the county, totaling \$1 billion at fiscal year-end 2004, including the tax collector's trust fund and a departmental trust fund, held outside the general fund. Including these resources, 2004-2005 TRAN coverage at maturity rises to a very strong 3.32x.

The county's projection of general fund cash is based on its proposed fiscal 2005 budget, which assumes a 7.6% increase in countywide assessed valuation and continued cuts in state local aid, as proposed in Gov. Arnold Schwarzenegger's May state budget proposal. Gov. Schwarzenegger's current budget proposal would cause Los Angeles County to lose about \$273.2 million from its budget in fiscal 2005, compared with existing law. The loss would result from the net effect of proposed cuts in state motor vehicle license fee revenues and various other cuts and reimbursement deferrals, offset by increased local allocations of property tax revenue. Despite the proposed cuts, the governor's budget blueprint reduces the state funding loss to the county in 2005 by almost \$200 million compared with his earlier January budget proposal. The county's proposed fiscal 2005 budget also contains \$269.7 million of budget cuts, including the elimination of 378 positions to absorb state cuts, plus large increases in worker's compensation costs, retiree health insurance, and unemployment insurance, in addition to \$35 million in unreimbursed state-mandated program costs.

Los Angeles County's financial position in recent years has improved due to timely budget adjustments after economic weakness in 2001, health care pressures, and the loss of a portion of state vehicle license fee funding in fiscal 2004. County budget cuts have left total county general fund expenditures nearly level over the past three years. At the same time, lost state aid was also partially made up for by strong growth in other revenues due to the expansion of Southern California's economy and reduced welfare rolls. County property tax valuations increased 8.2% in fiscal 2004, after 6.8% growth in fiscal 2003. The county's unreserved general fund balances on a GAAP basis have increased steadily, from \$294.3 million at the end of fiscal 1999 to \$1.31 billion, or 12.3% of expenditures and net transfers out, at fiscal year-end June 30, 2003. Unreserved balances increased \$161 million in fiscal 2003 alone, largely as the result of budget cutting. On a budgetary basis of accounting, the county estimates a drawdown in general county budget reserves to \$105.7 million at fiscal year-end 2004 from \$174.2 million in fiscal 2003, slightly better than last year's administrative budget proposal. County management has proposed a fiscal 2005 budget that would draw down reserves to \$91.7 million, or 0.7% of \$13.7 billion of net general county appropriations, which includes other funds in addition to the general fund.

The county invests its operating money and TRAN repayment amounts in the county-pooled investment fund. As of April 30, 2004, the pool had a book value of \$14.82 billion and a market value of \$17.59 billion; the pool is highly liquid, with an average maturity of 237 days. Investments (as of April 30), consisted of 56.33% in U.S. government and agency obligations, 24.03% in CP, 15.57% in CDs, and 2.42% in corporate notes. About 93.59% of the pool's participants are mandatory participants.

■ Long-Term Credit Risks

Some long-term credit risks remain, particularly from a scheduled phase out of federal Medicaid waivers on June 30, 2005, and the possibility that welfare caseloads may reverse their recent favorable trends. In addition, the county pension system will require increased contributions due to recent weak stock market performance and the eventual phase-out of the use of prior excess pension system earnings credits to reduce pension contributions. In fiscal 2005, the county will use \$400 million of prior excess earnings credits to fund a portion of its pension system contributions, although the county has been reducing its use of excess earnings credits by \$30 million per year for the past six years.

The county anticipates its health services budget operating deficit to grow from \$309.5 million in fiscal 2007 to \$740.1 million in fiscal 2008 as a result of the waiver expiration, without additional budgetary action, compared with proposed hospital enterprise fund appropriations in fiscal 2005 of \$1.7 billion. The fiscal 2004 budget provides a \$547.5 million contribution to the hospital enterprise fund from the county's general fund, slightly less than the year before, but contributions may have to rise due to the difficulty in closing facilities and the large indigent population that utilizes emergency room visits within the county. Local opponents of the county's plans to close a medical facility and reduce 100 beds at another facility have won court injunctions against the county. These problems have been mitigated by several other developments. New health care funding in the form of a voter-approved parcel tax was approved in November 2002, generating approximately \$140 million per year for the county hospital trauma system. In addition, the county received \$50 million in onetime funding related to the settlement of a lawsuit related to outpatient Medi-Cal rates, \$50 million in supplemental Medi-Cal inpatient payments in fiscals 2003 and 2004, and \$100 million in funding over two years from the state's selective provider contracting program waiver. Based on this new funding, revised projections show the health department's cumulative deficit not occurring until 2006-2007 (compared with earlier estimates of 2003-2004).

The health department has developed a redesign plan to restructure the county's health care budget. The first phase of the county's plan includes the closure of 16 clinics, reassignment of the High Desert Hospital as an outpatient clinic, the closure of the Rancho Los Amigos National Rehabilitation Hospital, and the reduction of 100 beds at the LAC+USC Medical Center effective July 1. Although the county board of supervisors approved the plan in 2002, in March 2003 the U.S. District Court-Central District of California issued a preliminary injunction that prohibited the county from closing Rancho (or from reducing service reductions that are covered by Medicaid) or from implementing the 100-bed reduction at the LAC+USC Medical Center.

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-

based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find Ratings, then Credit Ratings Search.

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Moody's Investors Service

Global Credit Research

New Issue

15 JUN 2004

New Issue: Los Angeles (County of) CA

MOODY'S ASSIGNS MIG-1 RATING TO TAX AND REVENUE ANTICIPATION NOTES OF LOS ANGELES COUNTY, CALIFORNIA

\$600 MILLION IN SHORT TERM DEBT AFFECTED

County
CA

Moody's Rating

ISSUE	RATING
2004-05 Tax and Revenue Anticipation Notes, Series A	MIG 1
Sale Amount \$600,000,000	
Expected Sale Date 06/14/04	
Rating Description Tax and Revenue Anticipation Notes	

Opinion

NEW YORK, Jun 15, 2004 -- Moody's Investors Service has assigned a MIG 1 rating to Los Angeles County's \$600 million issue of 2004-05 Tax and Revenue Anticipation Notes Series A. The notes are being issued to fund the County's mid-year cash flow needs and are secured by a pledge of unrestricted, fiscal 2005 general fund receipts. The rating reflects the County's stable financial position, a proposed budget which conservatively reflects uncertainties associated with the State budget by not including an unreasonable growth assumption, and the board's demonstrated willingness to make significant program cuts when necessary to maintain balanced operations. The County's total liquidity is a strength reflected in the note rating, even adjusting for the County's more expansive definition of borrowable resources than that used by most counties. The County still faces a number of notable long-term challenges, particularly in the health department, but these do not affect the credit quality of its note issue for the upcoming fiscal year. The County's general obligation bonds are rated Aa3. Its pension bonds are rated A1, its fixed asset lease obligations are rated A2, and its equipment lease obligations are rated A3. The outlook on these ratings is now stable.

COUNTY'S GENERAL FUND AND OVERALL LIQUIDITY ARE SATISFACTORY AND CONTINUE TO BE MUCH IMPROVED OVER PRIOR YEARS.

After an extended period of cash surpluses in its general fund, the County is projecting that it will experience a cash drawdown of \$266 million in fiscal 2004. However, the currently projected 2004 ending cash balance of \$652 million is \$259 million higher than the original projection of \$394 million, because the County's cash position at the beginning of 2004 was much higher than originally projected. Despite the draw-down, the 2004 ending cash balance still represents 5.0% of receipts, which is a more comfortable cash position than what the County has experienced through much of recent memory. Also noteworthy is the fact that the county's 2004 projection includes estimates for the last two months which likely reflect some conservative assumptions. Based on recent history, it is likely that the final June 30, 2004 cash position will surpass the current estimates.

The County's general financial position at the end of 2004 is expected to be essentially unchanged from the previous year. The overall general fund balance is not expected to vary significantly from the previous year's \$1.7 billion. Within this balance of June 30, 2003, we believe that much of the unreserved portion of \$1.3 billion represented reserves of varying degrees of availability, which afforded the County ample operating flexibility, although it appears as though the County did not have to rely on them to a significant degree.

Cash flow projections show that the County expects a \$288 million reduction in its cash position in 2005, with

a year-end cash balance of \$371 million or 2.8% of receipts. This projection appears reasonable, and it reflects increases of 1.8% in both receipts and expenditures from current 2004 estimated. The small increase in total expenditures is consistent with the budget, which includes sizable reductions, primarily reflecting the County's response to the state budget. The County's locally generated revenues have increased substantially in recent years, and the County's projections reflect more robust rates of growth. Property taxes are projected to grow by 5.0% in 2005, while in 2004 they grew by 3.8%, although this may be one of the most conservative elements of the current 2004 cash flow estimates.

The County's budget includes \$270 million in budgetary curtailments and a reduction of 378 full time positions in order to absorb \$167 million in escalating costs and \$102 million in funding reductions. The 2005 Cash flows show 1.8% increase in welfare warrants, while in 2004 a decrease of 4.1% is estimated. Salaries and Benefits are projected to increase by 4.5% while the 2004 estimated increase was only 2.9%. These two growth assumptions represent some of the most conservative elements in the 2005 projections. Although, if actual expenditures are less than these amounts, much of the savings would also be reflected in lower receipts from State and Federal sources, minimizing the positive impact on the year-end cash position. While portions of these increases also reflect growth in the County's locally-generated revenues, the overall projected increase in expenditures is conservative and consistent with the County's historic pattern. Each year the County's actual cash flow outperforms original projections and we expect similar results for 2005. While an actual decrease in ending cash balance is likely, we believe the final balance will be higher than the projected balance of \$371 million. But it is noted that the County's cash position continues to be highly dependent on state actions, most significantly the timeliness of certain health care reimbursements (SB855 and SB1255 payments) made by the state to the County. However the County's cash flows reflect very conservative assumptions regarding the timing of such receipts.

The amount of money available for interfund borrowing remains ample. This has improved significantly in recent years primarily due to the implementation by the County, in fiscal 1998, of a commercial paper program to provide construction financing for capital projects. Prior to the implementation of the commercial paper program, the County funded construction with internal borrowings executed through the sale of bond anticipation notes to the County's pooled investment fund. This practice reduced the amount of borrowable resources available to meet the County's cash flow needs. For the end of fiscal 2005, the County estimates that gross funds available for interfund borrowing will be \$883 million. Combined with the projected cash balance in the general fund, total available liquidity should equal \$1.2 billion or 9.4% of cash receipts.

The County estimates approximately a \$273 million impact from Governor's May proposals, most of which the County believes it can address by program reductions or eliminations. Some reserves are also expected to be used. We believe that any remaining revenue reductions would be minimal and easily absorbed with the use of reserves and cost reductions.

Outlook

Moody's has revised the outlook on Los Angeles County's long-term ratings to stable from negative. The stable outlook reflects the County's demonstrated ability to mitigate the negative effects of the state budget thus far on the County's financial position. While state budget actions could potentially result in significant revenue cuts for California counties, this risk appears to have lessened in recent weeks. To date, the County has displayed successful management of the challenges arising from the state budget crisis and Moody's believes that it can be expected to continue to do so. (For additional details regarding the State of California's credit position, please see Moody's Municipal Research dated May 21, 2004.)

KEY STATISTICS

Projected Amount Borrowed as % of Receipts, FY 2005: 4.6%

Actual Ending Cash as % of Receipts, FY 2003: 6.7%

Projected Ending Cash as % of Receipts, FY 2004: 5.0%

Projected Ending Cash as % of Receipts, FY 2000: 2.8%

Historical Minimum Audit Cash as % of Revenue, FY 2001-03: 5.4%

Alternate Liquidity (Estimated 6/30/05): \$ 883 million

Alternate Liquidity % of FY 2003 Receipts: 6.6%

Pledged Set-Aside timing (months before June): 4.2 months

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**Fitch Rates Los Angeles County, California's \$600MM TRAns 'F1+' Ratings**

09 Jun 2004 6:23 PM (EDT)

Fitch Ratings-San Francisco-June 9, 2004: Los Angeles County, California's (the county) \$600,000,000 2004-2005 tax and revenue anticipation notes (TRAns), series A are rated 'F1+' by Fitch Ratings. The notes will be sold through negotiation by a syndicate led by Lehman Brothers on or about June 15. The notes are dated July 1, 2004 and mature June 30, 2005.

Fitch's highest rating for short-term debt reflects the sound note repayment structure, strong coverage of all note repayment set-asides, and the availability of substantial borrowable resources throughout the fiscal year. The repayment deposit structure sets aside 100% of principal and interest two months in advance of note maturity. The county's long-term credit quality also is a rating factor, marked by recovery from a moderate recessionary impact and satisfactory year-end reserves, although financial operations remain narrowly balanced. Fiscal pressures continue and long-term credit considerations focus on the county's challenge in reforming its financially draining health care system as well as the impact of the state's sizable budget deficit.

The notes are secured by a first lien on unrestricted revenue in fiscal 2005. Pledged revenue is projected to total \$4.15 billion, covering note principal and interest 6.7 times (x). Funds for repay will be set-aside based on an aggressive schedule beginning in December 2004. By Jan. 31, 2005, more than one-half of the estimated principal and interest due will be impounded; the full amount will be set-aside by April 30. The projected cash flow covers all five set-asides well, ranging from 5.4x-12.2x. Also, the county has a substantial pool of resources available for the intrafund loans, with month-end balances in these funds ranging from \$856 million - \$3.1 billion. The fiscal 2005 cash flow projects ending the year with a moderate cash balance (\$371.4 million.) Historically the county's actual ending balances have been higher than originally forecast. The cash flow is based on the county's proposed budget, which is based on California's proposed budget as detailed in January 2004. Since then, the May Revision suggests a reduced revenue loss through the property tax shift and state program funding reductions. Nonetheless, the cash flow inherently includes some uncertainty regarding the state budget impact.

Los Angeles County's proposed fiscal 2005 budget incorporates little growth and assumes all salary negotiations are settled at no additional cost. Recent settlement with the county's largest union grants no salary increases, but other contracts remain unsettled. The general fund budget shows a small reduction to \$12 billion, reflecting reduced caseloads in many social service programs offset by natural increases in other expenditures. The general fund budget is balanced using all of the prior year's unallocated fund balance (\$456.7 million), although the county historically performs better than budget. Adhering to the budget's austere spending plan will require strong fiscal discipline, especially in upcoming labor negotiations.

The county continues to be unable to enact a Board-approved restructuring of its extensive health and hospital system. Board actions include the closing of several facilities and inpatient bed reductions at others, all of which have been litigated. The courts have issued temporary injunctions against the closings and reductions, and the county's fiscal 2005 budget assumes no facility changes are made. Nonetheless, the county estimates that the health department will run a sizable \$740.1 million operating deficit by fiscal 2008 if no action is taken. However, health system revenues are enhanced by county voters' approval of Measure B, a parcel tax dedicated to emergency and trauma medical care. Despite the board's determination to bring the sizable network under fiscal control, achieving self-sufficiency for the system will take continued diligence over several years. The county's ability to restructure its health care delivery system to operate within available and recurring resources will continue to be a sizable challenge, and a key component of credit quality.

Overall, Los Angeles County has made significant progress toward long-term financial stability in non-health areas. The general fund has run operating surpluses for each of the last seven years. While an operating loss is expected for fiscal 2004, the ending fund balance is expected to remain adequate.

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